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RUEHCV/AMEMBASSY CARACAS 0283
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RUEHSG/AMEMBASSY SANTIAGO 1697
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UNCLAS SECTION 01 OF 06 SAO PAULO 000505

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SUBJECT: A BUSY TWO WEEKS FOR LULA'S PARTY: PT READIES FOR CAMPAIGN
AS SCANDAL SHOWS SIGNS OF REVIVAL

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C O R R E C T E D C O P Y (Update Text Paragraph 12)

REF: (A) BRASILIA 888 AND PREVIOUS;(B) SAO PAULO 449;
(C)BRASILIA 727;(D)BRASILIA 640;(E) 05 SAO PAULO 1376;
(F) 05 SAO PAULO 1110; (G) 05 SAO PAULO 1071;
(H) 05 BRASILIA 1979 AND PREVIOUS

SENSITIVE BUT UNCLASSIFIED - PLEASE PROTECT ACCORDINGLY.

SUMMARY

¶1. (SBU) The ruling Workers Party (Partido dos Trabalhadores - PT) held its National Encounter in Sao Paulo, April 28-30, in preparation for the election campaign. Delegates authorized President Lula and party leadership to enter into electoral alliances with any willing partners, excluding only two major opposition parties and one small left-wing party. The PT continues to court the centrist Brazilian Democratic Movement Party (PMDB), so far without success. The party also announced that internal disciplinary procedures would not be pursued against individuals implicated in the political corruption scandal until after the October elections. Though PT members put up a brave front, they freely admit that while Lula has a strong chance of winning re-election, the party's prospects overall are poor. To make matters worse, PT former Secretary-General Silvio Pereira granted

two lengthy interviews to "O Globo" newspaper in which he recounted his version of the corruption scandal, one that was significantly at odds with the party line. While Lula took a soft line - "he has the right to say what he knows" - PT President Ricardo Berzoini publicly called Pereira a liar and a traitor. Pereira has been subpoenaed to appear before a Parliamentary Investigative Committee (CPI) to see if he will repeat his allegations under oath. In the May 7 PT primary in Sao Paulo state, Senator Aloisio Mercadante defeated Sao Paulo former Mayor Marta Suplicy to win the party's nomination for Governor. END SUMMARY.

NATIONAL ENCOUNTER

12. (U) President Lula's Workers Party (PT) held its 13th National Encounter April 28-30 in Sao Paulo. This was the PT's first Encounter since October 2001, and the first ever held while the party controlled the federal government. The purpose of National Encounters - which are less frequent and more important than annual party congresses - is to gather the faithful to assess the party's condition and strategize for the future. This year, the delegates were asked to debate, amend as appropriate, and vote on a document outlining the party's situation and proposed tactics in this election year, and another laying out the government's program. The National Encounter was attended by members of the PT National Directorate (DN), Ministers, Governors, Mayors, and Members of Parliament, along with delegations from foreign leftist progressive parties. ConGen Sao Paulo received an invitation from PT President Ricardo Berzoini and International Relations Secretary Walter Pomar, but was subsequently advised that the PT had decided to hold a closed encounter and was unable to accommodate observers.

13. (U) Poloff met May 5 with PT Senior Advisor for International Affairs Ana Maria Stuart to obtain a readout of the National Encounter and an update on the PT's preparations for national and state elections. Stuart explained that in 2005, the PT had invited

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a wide variety of individuals and institutions to participate in the celebration of its twenty-fifth anniversary, and had inadvertently and erroneously used the same mailing list for this year's National Encounter, resulting in a number of invitations that had to be rescinded, since the National Encounter was an event "of a different nature" than the anniversary party.

14. (U) Stuart, who had earlier (see ref E) shared with CG her concern over the divide between the PT's moderate, pragmatic majority faction and various leftist tendencies, especially over the government's conduct of macroeconomic policy, characterized the National Encounter as a success, noting the active participation of some 1,200 militants. She described how lengthy internal negotiations had ensured that the Encounter would be relatively free of acrimony and conflict. Though delegates ultimately adopted a resolution calling for an adjustment of economic policy, and especially a reduction of interest rates, they did so in a non-confrontational manner. The voices on the left that have accused Lula of selling out the working class and the poor since assuming the Presidency in January 2003 were mostly muted. The leftists, Stuart explained, realized that the PT was in trouble, and they too face a tough challenge getting re-elected and believe their best chance is via party unity.

15. (SBU) Another reason the leftists didn't try to disrupt the Encounter over economic policy, Stuart said, is that new Finance Minister Guido Mantega is much less a lightning rod for leftist criticism than his predecessor, former Minister Antonio Palocci. She nonetheless acknowledged that the loss of Palocci, who resigned under pressure March 27, was damaging to the party and the government. "It's too bad, what happened to him. He made a mistake. He thought he could do it within the law, access the financial information of that boy that was causing him so much trouble, but he was wrong, and he paid the price." (COMMENT: This version of events lacks plausibility. See ref D for an account of

the events that brought Palocci down. END COMMENT.)

PT SEEKS ELECTORAL ALLIANCES WITHOUT REGARD TO IDEOLOGY

¶6. (U) The most important decision that emerged from the Encounter, according to Stuart, was the authorization granted to President Lula and the PT's National Directorate (DN) to pursue electoral alliances across the political spectrum. Some wanted to limit any alliances to the PT's traditional partners on the left, the Communist Party of Brazil (PCdoB) and the Brazilian Socialist Party (PSB), but the majority approved an initiative that excluded only three parties as possible allies: the opposition Brazilian Social Democracy Party (PSDB); its conservative ally, the Liberal Front Party (PFL); and the leftist Popular Socialist Party (PPS), whose President (and likely presidential candidate), Roberto Freire, has been vocal in calling for Congress to pursue Lula's impeachment over corruption allegations. Delegates passed a "motion of repudiation" against the "PPS pro-impeachment movement."

¶7. (U) Stuart predicted that the PT will continue to court the large and influential centrist Brazilian Democratic Movement Party (PMDB). The PT has for some time been reaching out to the PMDB, offering the Vice-President's spot on the ticket, so far to no avail. The PMDB is scheduled to hold a national convention May 13, which may help determine its election strategy. Many of its leaders

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prefer to remain neutral in the presidential election to maintain flexibility at the state level, where the party is running gubernatorial candidates in 17 of the 27 states. An alliance with the PMDB, Stuart suggested, would, in some parts of the country, enhance the PT's appeal to middle-class voters who supported Lula in 2002 but have since distanced themselves from the party.

¶8. (U) The PT came into some media criticism for leaving the door open to alliances with such centrist and rightist parties as the Brazilian Labor Party (PTB), the Liberal Party (PL), and the Progressivist Party (PP), all of which form part of the governing coalition but have leaders and members who were implicated in the Congressional bribery scandal ("mensalao"). These three parties will all struggle to achieve the five percent threshold required in elections for the Chamber of Deputies to retain their privileges and their viability, and it is unclear whether any will be interested in an alliance with the PT, which, apart from Lula's prospects, faces rough sledding in Congressional elections. Stuart agreed with other insiders (ref B) who predicted that the PT, which in 2002 elected 91 members to the Chamber and currently holds 81 seats, will likely fall to around 60 seats; many would consider this an optimistic estimate.

ACCOUNTABILITY DEFERRED

¶9. (SBU) With respect to another critical issue, the PT ducked. The question arose at the Encounter of what to do about the numerous members implicated in the "mensalao" and other corruption scandals that dominated the political scene during the latter half of 2005. The delegates agreed that these members must be investigated by the PT's internal disciplinary machinery, but not until 2007, after the election, to prevent the opposition's taking advantage of the situation during an election year. This decision also generated cries of derision from the opposition and the media. The press also commented acerbically on the presence at the Encounter of Lula's former Chief of Staff, Jose Dirceu, who continues to advise Lula and influence PT strategy behind the scenes, and of former PT President Jose Genoino, who resigned in disgrace last July (ref H). Stuart, however, defended the decision and the discredited individuals: The PT, she said, didn't want to commit suicide in an election year; why give the opposition ammunition? She asserted that many PT Federal Deputies had "merely made the mistake of doing what the party Treasurer told them to do," and that when the PT had discovered the

wrongdoing of the Treasurer, Delubio Soares, it had expelled him. To prevent the problem from recurring, she said, the PT is seeking to name a campaign Treasurer (separate from the party's Treasurer), a financial expert, preferably a businessman, with a reputation for probity.

¶10. (SBU) Asked about the lingering impact of the corruption scandal, Stuart predicted that the opposition would continue to raise it. Sounding much like Lula himself, she complained that "the people who have been running this country for five hundred years will never be able to get over having a worker as President. They're unable to spare him any criticism or give him credit for anything." But the public, she continued, was tired of the constant reporting of the scandal, and wouldn't pay attention. Besides, there were newer, fresher scandals to exploit. She pointed to the fact that none of the 46 individuals - including two former Deputies and more than ten current and former Congressional staffers -

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arrested the previous day by Federal Police in "Operation Bloodsucker" -- a scheme to defraud the public in the purchase of ambulances for municipalities -- was affiliated in any way with the PT.

¶11. (SBU) COMMENT: Per press reports, the PT is having trouble finding a campaign Treasurer who meets the requirements and is willing to take on the task. Stuart's explanation of the bribery scandal lacks plausibility, but no more than that of many PT leaders - former Sao Paulo Mayor Marta Suplicy comes to mind, but she is far from alone - who continue to assert, in the face of the final report (ref D) of the Parliamentary Investigative Committee on the Postal Service ("CPI dos Correios") and the accusations of the Attorney General (ref C), that the existence of the "mensalao" (payoffs to Deputies of the governing coalition in return for votes on government-sponsored legislation) has never been established and that the PT was at worst guilty only of use of "Caixa 2," the solicitation and use of unreported and unaccounted campaign funds. END COMMENT.

VOICES FROM THE LEFT

¶12. (U) Stuart noted that despite the general unity and amity at the Encounter, one tiny faction on the farthest left wing of the party, the Trotskyite group O Trabalho ("Work"), had garnered some attention with its motions. A proposal to undo the privatization of the Rio Doce Valley Company (CVRD), the world's largest mining company, was defeated by the surprisingly slim margin of 358-305. This may have been the PT's way of criticizing privatizations carried out during the PSDB administration of Fernando Henrique Cardoso; their efforts to convoke a CPI to investigate these privatizations have come to naught. Another resolution, much more easily defeated, called for nationalization of troubled air carrier Varig, a bizarre notion that would probably have required the State to assume the company's large debts. Stuart also noted that O Trabalho had called for Brazil's withdrawal from Mercosul on the grounds that the trade bloc was an instrument of multinational corporations; this motion also did not prosper. She predicted that many of the social movements that comprise the PT's core constituencies, such as the Landless Rural Workers' Movement (MST), would continue to criticize the Lula government's economic and social policies while at the same time working for Lula's re-election.

SILVIO PEREIRA SPEAKS OUT

¶12. (U) The PT's post-Encounter peace was disturbed May 7 when "O Globo" published two lengthy interviews with Silvio Pereira, the party's former Secretary-General. Pereira resigned last July amid allegations that he had controlled the "mensalao" scheme. He became

for a time a poster-boy for corruption when it was revealed he had accepted the gift of a Land Rover from a company that did a lot of business with Petrobras, the partially privatized state petroleum company. Pereira told journalists that:

-- Businessman Marcos Valerio Fernandes de Souza had planned to raise the sum of one billion reais (approximately USD 400 million at

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that time) via state-owned enterprises or companies with extensive ties to the State or lucrative government contracts. He listed three banks - Banco Economico, Banco Mercantil de Pernambuco, and Banco Opportunity - and indicated that Valerio was involved in shady livestock deals as well.

-- Valerio's plan was to establish and maintain a pool of companies dependent on government contracts to draw on for funds to pay off 2002 campaign debts and 2004 municipal campaign expenses.

-- Valerio, a former Central bank employee, provided ordinary and entirely legitimate services to the PT in the 2002 elections, but later grew so powerful that he was unaccountable and uncontrollable. For example, PT ex-Treasurer and designated scapegoat Delubio Soares knew nothing about the withdrawals of funds from Banco Rural that were among the most concrete criminal acts of the scandal. Delubio "is not corrupt. He isn't."

-- Four individuals - President Lula, then-Chief of Staff Dirceu, then-PT President Genoino, and Senator Aloisio Mercadante (see paragraph 15) - were in charge of the PT, but Lula wasn't responsible for any criminal activity. Dirceu also kept his distance from Valerio and his activities.

-- Valerio's schemes involved numerous political parties and politicians, and were par for the course in Brazilian politics. "Behind Marcos Valerio, there must be a hundred Marcos Valerios. It's a mechanism, and now it's continuing in the country." When the scandal broke, Valerio threatened to "give over everything and bring down the Republic," but settled in the end for telling only about half of what he knew.

-- Pereira himself had the difficult task of finding jobs in the federal government for all the PT loyalists and allies who wanted them. "These people aren't easy; they tried everything...My job was to convince PT Ministers to free up jobs for allies. When the PMDB came on board in April [2003] and the government was already filled, I was stuck with the hot potato." He claims that neither he nor the PT Ministers did anything unethical, but rather ran a legitimate process, despite the claims of ex-Deputy Roberto Jefferson (PTB-RJ).

¶13. (SBU) Many of Pereira's allegations are not new, though this may represent the first time a PT insider has spoken this explicitly, and many seem self-serving. He was reportedly nervous throughout the interviews and later regretted having granted them. He even went so far as to ask "Globo" not to publish them, claiming he was under intense pressure to maintain silence and could be killed for having spoken. President's Lula's reaction to the publication was calm, perhaps reflecting Pereira's assertions that he was not involved in any wrongdoing. "He's free to tell what he knows," Lula said. Other party officials were not so forgiving. PT President and former Labor Minister Ricardo Berzoini expressed surprise at the revelations, noting that Pereira "had every opportunity to say that to the CPI, the Federal Police, and the Public Ministry [prosecutor's office]." He went on to accuse Pereira of telling lies and betraying the party. One immediate result of the interviews was that he was immediately subpoenaed to appear before the "Bingos CPI." His attorneys immediately sought a dispensation, but the Supreme Court denied it, and he is scheduled to testify May 10. His attorney claims Pereira is emotionally over-wrought and is taking anti-depressants.

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MERCADANTE WINS SAO PAULO PRIMARY

¶14. (SBU) Also on May 7, nearly 70,000 PT members went to the polls in Sao Paulo state to choose the party's gubernatorial candidate. Senator Aloisio Mercadante defeated Marta Suplicy by 3,757 votes, 52.8 percent to 47.2 percent. Prior to the primary, each candidate had pledged to support and work for the other, and for the entire party ticket, in the event of defeat. By all accounts, Mercadante - the government's leader in the Senate who has coordinated every Lula campaign since 1982 and was Lula's running mate in his unsuccessful 1994 presidential campaign - was clearly Lula's preferred candidate.

As predicted, Suplicy outpolled Mercadante almost 2-1 in Sao Paulo city, but Mercadante defeated her by about 2,000 votes on the city's periphery and trounced her by 10,000 votes in the state's interior. Per ref B, Mercadante benefited significantly from the support of Federal Deputy Joao Paulo Cunha of Osasco (western suburbs), who is influential throughout the periphery and had himself originally planned to run for Governor. One of the most notorious of the "mensaleiros" (politicians implicated in the mensalao scandal, Cunha was recently acquitted of wrongdoing by the full Chamber of Deputies amidst vocal public reprobation, though he still faces federal charges (ref C). Even though Mercadante is not expected to defeat PSDB nominee and Sao Paulo ex-Mayor Jose Serra, who polls still show as likely to prevail in the first round, the PT is counting on his high national profile to enable him to give Serra a run for the money and to garner votes for Lula in critical and populous Sao Paulo state. In 2002, Mercadante received 10 million votes for Senator in the "red wave" that swept into office not only him and Lula but many PT Senators and Deputies.

COMMENT

¶15. (SBU) Silvio Pereira's comments certainly don't help the PT cause, but it's too early to tell whether or not they will do lasting damage to Lula's re-election campaign. It is similarly difficult to predict the fallout from Bolivia's May 1 nationalization of Petrobras facilities in that country (ref A). Most observers say there will be none, because Brazilians don't pay attention to foreign policy and don't base their votes on it, although significant increases in the price of gasoline, cooking gas, or electricity, should such occur, could get their attention. Lula's soft response may also generate opposition; many Brazilians do not enjoy or appreciate the optics of Brazil and Petrobras seemingly getting kicked around by lowly Bolivia. On the domestic front, the PT continues to face a challenge in securing an alliance with the PMDB; the opposition PSDB is also avidly courting the PMDB, and these two parties are in some ways more compatible. The PMDB is holding a national convention May 13 at which, literally, anything can happen. We also are continually being reminded that this is Brazil, and that life does not begin until after July 9, the day the World Cup championship ends. END COMMENT.

¶16. (U) This cable was coordinated/cleared with Embassy Brasilia.

MCMULLEN